

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In Re: : Case No. 05-60006
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REFCO, INC., :
:
Debtor. :
:
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AXIS REINSURANCE COMPANY, : 07-0712-RDD
:
Plaintiff, :
:
v. : One Bowling Green
: New York, New York
BENNETT, et al., :
: October 12, 2007
Defendants. :
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TRANSCRIPT OF HEARING ON SUMMARY JUDGMENT MOTION
BEFORE THE HONORABLE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

For Tone Grant: NORMAN L. EISEN, ESQ.
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(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

For Dennis Klejna, HELEN B. KIM, ESQ.
Gerald Sherer, Baker & Hostetler LLP
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1 (Proceedings began at 10:11 a.m.)

2 THE COURT: Okay. We're here on the Refco / Axis
3 Reinsurance Company summary judgment motion.

4 MS. KIM: Good morning, Your Honor. Helen Kim with
5 Baker and Hostetler. I represent defendant -- counterclaim
6 plaintiff, Dennis Klejna, and I'm presenting the oral argument
7 on behalf of Mr. Klejna, as well as counterclaim plaintiffs
8 William Sexton, Gerald Sherer, and Philip Silverman.

9 Your Honor, we seek summary judgment on the grounds
10 that the express terms of the Axis policy requires Axis to pay
11 defense costs as incurred. There's no dispute between the
12 parties that where the terms of a policy provides for
13 advancement of defense costs insurer must advance until there's
14 been an adjudication of no coverage. And for that purpose,
15 Your Honor, we have cited the WorldCom and Kozlowski [Ph.]
16 cases, as well as numerous other cases around the country.

17 So we start in this case with the language of the
18 U.S. Specialty policy, the primary policy as to which the Axis
19 policy follows form. The insuring agreement (a) of the U.S.
20 Specialty policy requires that the insurer pay losses, which
21 includes defense costs as incurred for a claim for wrongful
22 acts, and condition (b)(2) of the primary policy provides that
23 the insurer will pay the covered defense costs on an incurred
24 basis if it is finally determined that any defense costs paid
25 by the insurer are not covered under the policy.

1 The insureds agree to repay such noncovered defense
2 costs to the insurer. So the Axis policy, which follows the
3 form of the U.S. policy, has a two-step process, payment as
4 incurred of defense costs, and repayment of those defense -- of
5 noncovered defense costs if there's a final determination of no
6 coverage.

7 So the crux of the issue before this court is the
8 legal interpretation of Axis's obligation to pay defense costs.
9 Now, Axis takes the position that its obligation to advance
10 defense costs are triggered only when coverage is undisputed.
11 According to Axis, and I quote from its brief, "The Axis policy
12 expressly allows Axis to make the initial determination of
13 whether or not something is covered."

14 Now, we've searched the Axis policy and the
15 underlying primary policy high and low and we can't find any
16 provision in the Axis policy that gives Axis that right and
17 Axis cites none. I note it seems that U.S. Specialty and
18 Lexington, the first Axis carriers, also couldn't find any
19 provision either because it's undisputed that based on the very
20 same language of that primary policy both U.S. Specialty and
21 Lexington advanced defense costs until the policies were
22 exhausted.

23 We note that condition (d)(2) would be rendered
24 illusory if Axis could avoid its obligation to advance simply
25 by disclaiming coverage. So when we look at the term "payment

1 of covered defense costs," we believe that the term "covered"
2 refers to a Claim -- that's capital C claim and that's a
3 defined term -- for a wrongful act, in this case a securities
4 claim.

5 And to determine whether an action is covered we must
6 look to the face of the pleading, the complaint, to see if
7 there are any facts or grounds alleged that would bring the
8 action within the liability coverage purchased. That's
9 precisely the approach that was taken by the Appellate Division
10 first department in Kozlowski and other cases as well. So,
11 Your Honor, we submit that if this were a car accident, this
12 would not be a claim for a wrongful act. We would acknowledge
13 that based on the pleadings on the face of the complaint that
14 such a claim would not be covered for payment of defense costs.

15 Now, in this case, Axis concedes that the underlying
16 actions constitute a claim which falls within the insuring
17 agreement. You note that they make that express concession on
18 page 12 of their brief, but it takes the position that it's
19 entitled to apply the knowledge exclusion and that this court
20 must defer to Axis's initial determination that the knowledge
21 exclusion has been triggered. For that purpose, Axis asserts
22 that the knowledge exclusion has been triggered by
23 Mr. Bennett's alleged knowledge.

24 We submit, Your Honor, that as a matter of law Axis
25 can only invoke a policy exclusion to avoid coverage if it can

1 show that the allegations of the complaint cast the pleadings
2 solely and entirely within the policy exclusions. Both the
3 Tyco case and the Carlin Equities case, which Axis brought to
4 the Court's attention by letter on Wednesday make that point
5 very clear and I want to thank Axis for bringing the Carlin
6 Equities case to the Court's attention and, in fact, if I had
7 found the case myself I would have relied upon it.

8 Both Koslowski and Tyco on all three cases,
9 Koslowski, Tyco, and Carlin Equities make clear that unless
10 it's clear from the face of the pleadings in the underlying
11 action that the claims fall entirely within the scope of an
12 exclusion, the insurer's obligation to advance defense costs
13 remains. Here Axis cannot meet that burden and it has not.

14 Axis can't establish from the face of the pleadings
15 in our underlying actions that the claims fall within the
16 knowledge exclusion. In fact, as the Court is aware the issue
17 of Bennett's knowledge, what he knew, and when he knew it is
18 hotly disputed. It's at the heart of the underlying securities
19 actions, as well as the criminal action against Mr. Bennett and
20 others. That issue will have to be resolved in those
21 underlying actions and can't be resolved on the face of the
22 pleadings.

23 So we're left with a situation where an exclusion is
24 disputed and, in fact, the counterclaim plaintiffs have
25 asserted that exclusion doesn't even exist at all because it

1 was improperly added by Axis after the commencement of the
2 policy period and in terms of the police binder. We're not
3 aware of any case, and Axis cites none, where advancement was
4 denied based on an exclusion that was disputed or that required
5 proof of a disputed fact.

6 In fact, therefore, Your Honor, Axis has the
7 obligation and retains the obligation to pay defense costs
8 subject to their right of recitment of those payments if
9 there's a final determination of no coverage.

10 That's the only argument I have, Your Honor, on the
11 primary argument for summary judgment.

12 I do want to briefly address their -- Axis's request
13 for priority -- on priority of payments, if I may. Your Honor,
14 in their opposition papers, Axis asks the Court to include a
15 finding of priority of payments. They made that similar
16 request with respect to the indicted officers' motion for
17 preliminary injunctive relief. Your Honor, we believe that
18 that request is improper. There's no pleading or motion before
19 the Court requesting allocation or determination of priority as
20 between the parties and that any order in this case in the
21 event the Court grants summary judgment should remain neutral
22 on the issue of priority payment so that payments can be made
23 in accordance with the terms of the policy.

24 Unless Your Honor has any questions.

25 THE COURT: I may have questions of you after I hear

1 from the other parties, but right now, I don't.

2 MS. KIM: Thank you, Your Honor.

3 MR. WALSH: Good morning, Your Honor. Michael Walsh,
4 Weil, Gotshal and Manges on behalf of the director defendants.

5 THE COURT: Good morning.

6 MR. WALSH: I concur in Ms. Kim's presentation. I
7 just wanted to expand a little bit on the contract
8 interpretation so not going to go through everything that she
9 referred to.

10 It seems like, you know, when I look at all the
11 pleadings back and forth when it comes down to those three
12 little words "cover defense costs" and Axis is trying to read
13 so much into that one word "covered," that undefined term
14 basically that they can as a binding matter determine not to
15 pay until everything is resolved in terms of coverage, the
16 insuring agreements and exclusion. We think that that is an
17 unreasonable interpretation. We think that it's putting too
18 high a burden on one little undefined word.

19 Our interpretation is, as Ms. Kim said, which defense
20 costs that on their face fall within the terms of the insurance
21 agreement -- insuring agreement, require advance unless and
22 until a court finally determines that coverage does not exist.
23 Ms. Kim, you know, tracked through the various definitions to
24 say that it falled within the insuring agreement.

25 So what we think is a better way to look at this is

1 almost a two-part test: Can the Court make a determination
2 today that the claims fall within the Side A coverage? The
3 insuring agreements which refer to claim loss, defense costs,
4 and wrongful act, the answer is yes, the claim was covered;
5 step two would be can the Court make a determination today that
6 an exclusion applies. If the answer is yes, then the claim no
7 longer falls within the policy coverage we're done; if the
8 answer is no, then the claim remains covered for step one until
9 such time as there is such a determination.

10 We think that's the only way to sort of reconcile all
11 the language here, and we think that that's certainly
12 consistent with the, you know, New York policy to give
13 directors what sophisticated businesspeople would have expected
14 in the D&O policy. We think it's certainly consistent with the
15 WorldCom case, which although it turned on the issue of
16 precision came out the same way requiring the advancement of
17 defense costs pending a final determination on the rescission
18 in question.

19 Axis tries to distinguish that case in two ways.
20 First, they argue that the language in the WorldCom policy is
21 materially different than what we have here in the U.S.
22 Specialty policy, what we call the primary policy, but I think
23 that is much too strained an interpretation. If you look at
24 the language -- the advancement language in WorldCom, which
25 starts off with the phrase "Under Coverage A and Coverage B the

1 insurer shall advance," I think the only reasonable
2 interpretation of that is that it's referring to covered
3 defense costs, that it is referring to defense costs that come
4 within the insuring provision of Coverage A and Coverage B.

5 As I mentioned earlier, Axis also tries to
6 distinguish WorldCom because it's a rescission case but, you
7 know, we have to look at the ultimate result, Your Honor, and
8 if whether it's rescission or the application of exclusion or
9 any other theory which denies coverage. It's the same thing
10 for the director defendants, so we don't think that's an
11 appropriate way to distinguish that court.

12 So in summary, since we have -- we don't believe we
13 have any facts that are in dispute here. We have the
14 underlying litigation which falls within the definition of
15 wrongful acts, et cetera, so the only thing that is left for
16 the Court is this interpretation. And our position, Your
17 Honor, is that the only reasonable interpretation is the one
18 that we're giving to the policy. The only interpretation which
19 would, in essence, give effect to the obligation to advance is
20 our interpretation and we request the Court enter a judgment
21 for us on the basis of a summary judgment.

22 THE COURT: What is on record showing that your
23 clients dispute the exclusion, the fraud exclusion?

24 MR. WALSH: I think that we submitted statement of
25 facts where we said that the underlying coverage comes within

1 the terms of the definition of the policy. I'm not sure we
2 need to go any further than that.

3 THE COURT: Okay.

4 MR. EISEN: Good morning, Your Honor. Norman Eisen,
5 counsel for Tone Grant and arguing on behalf of Mr. Grant,
6 Mr. Bennett, and Mr. Trosten.

7 Your Honor, we have addressed the issues before the
8 Court once, twice actually on preliminary injunction and twice
9 again today, and we would rely on the arguments advanced by the
10 previous counsel by Ms. Kim and Mr. Walsh and will not belabor
11 the identical arguments for the Court. If the Court has
12 questions for us at this time or later, of course, we're
13 pleased to entertain them or if the Court would like to hear
14 from us, we're prepared to do that, but we do stand on the
15 identical arguments. They are the same -- it is the same
16 policy and the same arguments.

17 THE COURT: Okay. Again, I may have questions for
18 you after I hear from Ms. Gilbride, but right now I don't.

19 MR. EISEN: Thank you, Your Honor.

20 MR. JEROME: Excuse me, Your Honor. I note that
21 nobody has raised an argument for Mr. Murphy. Ms. Kim left him
22 out of the description of those to whom she was speaking. For
23 the record I would just like to say I adopt all of the
24 arguments, [inaudible].

25 THE COURT: Okay. All right. Thank you.

1 MS. GILBRIDE: Good morning, Your Honor. Joan
2 Gilbride for Axis Insurance Company.

3 THE COURT: Good morning.

4 MS. GILBRIDE: Your Honor, we have submitted to Your
5 Honor in an exhibit to our opposition to the motion for summary
6 judgment a copy of the WorldCom policy. We submit that if you
7 compare the relevant language, it's clear that the language in
8 the Axis policy is different. WorldCom policy says that the
9 insurer shall advance defense costs, then says in a separate
10 place, they must advance defense costs. There's no requirement
11 or no indication that those defense costs must be covered. The
12 language in the Axis policy that makes the Axis policy
13 materially different is the word "covered." And, Your Honor,
14 frankly based on, you know, years and years of court
15 interpretations that word "covered" has a meaning. It has a
16 meaning to anyone who purchases insurance, anyone who writes an
17 insurance policy. The word "covered" has a meaning. It can't
18 just be deleted and excised from the policy, which is really
19 what the insureds would like Your Honor to do.

20 And, you know, the way the word "covered" has been
21 interpreted is that you must look at the insuring agreement.
22 The insuring agreement has to be triggered. Then you look at
23 the exclusions and what's left after you look at the insuring
24 agreement minus exclusions is what's covered, so the Court must
25 look at both. There must be a trigger of the insuring

1 agreement and the complaint must not fall within the
2 exclusions.

3 Your Honor has previously ruled that Axis's request
4 that the exclusions be considered has to be litigated
5 elsewhere. It can't be litigated now. It overlaps with the
6 underlying securities case and, you know, so Axis is precluded
7 on that basis from litigating the applicability of the
8 exclusions. But I think Your Honor hit it right on the head
9 when you asked, what is in the record by these insureds to show
10 that the exclusions don't apply. We submit it's their burden
11 on summary judgment to make that argument and that argument has
12 not been advanced.

13 In fact, we've made the argument that based upon the
14 (8)(k) where Refco essentially admitted that there were
15 undisclosed receivables that disclosed -- that admission is an
16 admission of guilty knowledge on the part of Mr. Bennett.
17 Mr. Bennett signed the warranty. Mr. Bennett, you know,
18 warranted to the insurer that there was no information at the
19 time he signed that warranty on behalf of all of the insureds,
20 that he had any knowledge or any potential claims.

21 Your Honor has already ruled that we can't get into
22 that and so, you know, we haven't extensively briefed that, but
23 certainly these insureds have not put anything before the Court
24 to support their position that defense costs should be covered.

25 THE COURT: Well, let me explore that a minute. The

1 Klejna group has done that, right? They say in their
2 complaints, which they attach, their cross-claims, that Axis
3 inserted the knowledge exclusion after the fact improperly.
4 They also say that the issue of the fraud and its imputation to
5 any of the insureds is at issue in the District Court
6 litigations.

7 MS. GILBRIDE: Your Honor, that is absolutely in
8 their counterclaim. It's our understanding based upon your
9 prior ruling that those issues were either not to be explored
10 at this point, but they certainly have not been advanced for
11 summary judgment purposes.

12 THE COURT: Well, no, but I'm going to get to that in
13 a second. I mean, is there any doubt from the record -- and I
14 guess I was thinking about the question I asked Mr. Walsh, his
15 clients did move, as did Mr. Eisen's clients, to dismiss Axis's
16 complaint on the basis of the overlap doctrine. Those motions
17 to dismiss are in the record and they state that the issues on
18 fraud and the warranty will be determined in the District Court
19 actions.

20 So I think their point is that once the Court sees
21 that there is a dispute as to coverage and/or the applicability
22 of an exclusion and/or the right to rescind, the advancement of
23 defense costs needs to continue until that dispute is resolved
24 by judicial order, and I think that's their point rather than
25 that it has to be resolved now.

1 MS. GILBRIDE: Well, Your Honor, we disagree with
2 that point. We believe that in order to prevail on summary
3 judgment with respect to advancement, the insureds -- all the
4 insureds have to show that the defense costs are covered and to
5 show that there is coverage there has to be not only a trigger
6 of the insuring agreement, but also there -- the exclusions
7 must not apply, so I think their argument puts the cart before
8 the horse. There has to be --

9 THE COURT: What case supports that?

10 MS. GILBRIDE: Your Honor, I think if you look at the
11 Carlin Equities case, I think if you look at the Tyco case, I
12 think if you look at Schiff v. Flack, which is a New York Court
13 of Appeals in 1980, it's clear that the word "covered" is
14 construed --

15 THE COURT: No, I'm talking about the more narrow
16 issue, which I think is the issue here, which is the issue of
17 whether there's an ability to withhold defense costs pending
18 the determination of a coverage dispute.

19 MS. GILBRIDE: As far as Axis is aware, the only case
20 that we've been able to find that deals with the precise
21 language in the Axis policy, and I don't think it answers the
22 question that you've just raised, is the Carlin Equities case.
23 I don't believe that there is a case. I'm not aware of any
24 case that addresses that precise question, but we believe that
25 the language of the policy, and based upon contract

1 interpretation principles and insurance contract interpretation
2 principles that our argument, which is that you have to look at
3 those, the insuring agreement and the exclusions is supported
4 by those principles and by, you know, case law which doesn't
5 just deal precisely with this factual scenario, but it deals
6 with the contract interpretation of principles that must --
7 that have to guide the Court's interpretation.

8 THE COURT: Okay.

9 MS. GILBRIDE: And, you know, again just to emphasize
10 in the WorldCom case, the posture of that case before the
11 District Court was entirely different than we're in. In that
12 case, the insurers were seeking to rescind the policy and there
13 was no dispute as to coverage, so I don't believe that there's
14 any case that supports the position that's being advanced by
15 the insureds either. It's simply an issue that perhaps
16 precisely has not been addressed.

17 Your Honor, we believe our interpretation of the
18 policy is reasonable. We think, you know, under basic contract
19 interpretation principles that the Court should enforce the
20 policy as written and on that basis we believe that the motion
21 for summary judgment should be denied.

22 THE COURT: Okay. On the contract interpretation
23 principles, you didn't really address this I think in your
24 brief, but I'll give you a chance to address it now: what is
25 your response to the statement in the movants' papers in which

1 they rely upon WorldCom, as well as three Second Circuit
2 opinions which state that, in the absence of extrinsic
3 evidence, where there is an ambiguity, it must be read against
4 the insurer?

5 MS. GILBRIDE: Your Honor, I think we've cited
6 several Second Circuit cases which make it clear that if intent
7 is a question of fact, if there's a dispute as to intent, if
8 there are two reasonable interpretations of a policy that that
9 is a question of fact that precludes summary judgment.

10 THE COURT: But are those insurance company cases
11 that deal with this where there was no evidence of any -- no
12 extrinsic evidence for interpreting an ambiguity?

13 MS. GILBRIDE: Yes, Your Honor. We've cited
14 insurance company case -- the Parks case, Second Circuit case,
15 and several other cases we cited deal with the interpretation
16 of insurance contracts and those courts hold that if intent --
17 well, they say that if there's -- if the Court finds that
18 there's an ambiguity, that the Court must look at extrinsic
19 evidence. We've not made this motion for summary judgment.
20 The insureds have. It's their burden to establish one way or
21 the other whether there's an ambiguity or not an ambiguity.
22 They've taken inconsistent positions on that, but if the Court
23 finds there's an ambiguity, the Court is obligated to look at
24 extrinsic evidence. It's not our burden to put that extrinsic
25 evidence before the Court.

1 Our position is that there's no ambiguity, Your
2 Honor. Our position --

3 THE COURT: Let me explore that. Why do you say that
4 it isn't your burden to put extrinsic evidence before the
5 Court, given the statements in the case law that say that in
6 the absence of extrinsic evidence an ambiguity will be
7 construed against the insurer?

8 MS. GILBRIDE: Your Honor, our fundamental position
9 and the position we've advanced from the beginning of this case
10 is that the policy language is clear and unambiguous.

11 THE COURT: No, I understand that point, but I'm just
12 going to the other point.

13 MS. GILBRIDE: Okay. So the insureds have argued or
14 some of the insureds have argued that there may be an
15 ambiguity. I think essentially that's what they're saying and
16 I am not aware of any case law that says it's the insurer's
17 obligation to establish the insured's argument that there's an
18 ambiguity. Our position is that there's no ambiguity.

19 And if they want to argue that there is an ambiguity,
20 I think it's their burden to put that information before the
21 Court. Just for the record, it's not our -- the primary policy
22 with this language, which we are arguing is clear and
23 unambiguous was not a policy drafted by Axis, so we don't
24 have -- it was drafted by another insurer, the primary insurer,
25 so we don't have Axis without, you know, subpoenas or, you

1 know, some discovery to find out what exactly was in the mind
2 of the drafter and that's the type of discovery that would
3 normally occur if the Court was to find there was an ambiguity.

4 This -- you know, we're before Your Honor on a very
5 expedited schedule, on a very fast pace, and that's all been at
6 the request of the insureds. Our position is if we -- you
7 know, we think the language is clear. We don't think it's
8 ambiguous, so we don't want to point to extrinsic evidence to
9 support their position.

10 THE COURT: Okay.

11 MS. GILBRIDE: Do you have any other questions for
12 us, Your Honor?

13 With respect -- I think Your Honor is aware of this,
14 but the other argument advanced by Mr. Klejna's counsel that
15 the carriers below us had the same language and that they --

16 THE COURT: They don't have the exclusion you have.

17 MS. GILBRIDE: Exactly. I don't think I have
18 anything else. Thank you, Your Honor.

19 MS. KIM: Well, Your Honor, just briefly.

20 THE COURT: Well, I'm sorry, but --

21 MS. KIM: Oh, I'm sorry.

22 THE COURT: Is there any issue -- if I ruled in favor
23 of the movants here, what would be the consequence? It would
24 be payment, right?

25 MS. GILBRIDE: Yes, Your Honor.

1 THE COURT: Okay. All right. You can go ahead,
2 Ms. Kim.

3 MS. KIM: Well, Your Honor, it's our position the --
4 that the terms of the policy are clear and unambiguous and that
5 if there were a -- that there is no provision in the policy
6 that gives Axis the unilateral right to make an initial
7 determination of the application of an exclusion. In fact, I
8 was reminded of that commercial from the '80s, "Where's the
9 beef?" They kept saying the terms -- this policy expressly
10 provides that Axis can make that initial determination. I
11 don't see that anywhere. They haven't cited any provision
12 anywhere.

13 We believe that in order to have a second sentence of
14 condition (d)(2) apply, the recoupment provision, the repayment
15 provision, the only way that provision ever has any meaning
16 whatsoever is if Axis has an obligation to pay defense costs
17 that are disputed until there is a final determination of no
18 coverage. Otherwise, Your Honor, they would never -- they
19 could simply disclaim coverage. They would never even have to
20 reserve -- pay defense costs under a reservation of rights.
21 That scenario would never arise, because under their reading
22 they could just disclaim coverage and there would never be any
23 advancement of disputed defense costs, Your Honor.

24 So we believe it is their burden to come forward with
25 extrinsic evidence. They didn't do so, and therefore we

1 believe that the contractual interpretation is clear. There
2 has to be advancement of defense costs until there is a final
3 determination -- excuse me -- of no coverage.

4 We note that in the Carlin Equities case there was a
5 determination with respect to the application of an exclusion
6 for one of the insureds. That was Mr. Mochweller [Ph.]. But
7 that was a determination made on summary judgment from the face
8 of the pleadings. The reason he was excluded was because it
9 was -- he was admittedly not an officer or director of Carlin
10 and he didn't fall within the management carve-back provision.
11 That was a determination that the Court could make from the
12 face of the pleadings to which there was no dispute. And I
13 believe that Axis also raised -- posited a problem, an issue.
14 They said, well, the policy also has -- the Axis policy has an
15 exclusion for any case arising out of the McElreath [Ph.] case.

16 Well, if we had submitted and tendered a case that
17 was squarely brought into issue, the allegations of the
18 McElreath case, they could have moved for summary judgment on
19 the face of the pleading saying, no, that's not covered, but
20 they can't do that here, Your Honor. They have not crossed
21 move for summary judgment, because there is a disputed question
22 as to the underlying coverage applicability of exclusion and I
23 agree with Mr. Walsh's two-part test.

24 If there is an exclusion and the Court cannot
25 determine from the face of the pleadings that the underlying

1 action falls entirely within the scope of that exclusion, then
2 the burden remains on the carrier to advance until that
3 underlying question is resolved in the underlying action.

4 MS. GILBRIDE: Your Honor, can I just address some of
5 the arguments that have been advanced?

6 THE COURT: Well, does anyone else have any response
7 on it before I hear from Ms. Gilbride?

8 MR. WALSH: Just a couple of little things, Your
9 Honor. Michael Walsh, Weil, Gotshal.

10 You asked me a question earlier about, you know, is
11 there facts in this record about the director defendants
12 denying that the exclusion applies. I'm still not sure if
13 that's, you know, relevant to the discussion but it is a matter
14 of judicial record that we have filed answers to, you know, the
15 complaints in the underlying action where we did deny all those
16 allegations.

17 On point of ambiguity, we're certainly not arguing
18 that the language is --

19 THE COURT: I'm sorry, did you answer? I thought you
20 moved to dismiss. Did you answer also?

21 MR. WALSH: In the underlying actions.

22 THE COURT: Oh, I understand. All right. The
23 federal -- the District Court actions?

24 MR. WALSH: yes.

25 THE COURT: All right.

1 MR. WALSH: On the issue of ambiguity, we're not
2 taking the position that the language is ambiguous. We think
3 it is unambiguous, but if the Court has to get to that issue,
4 we think that it -- that Rule 56(e) requires Axis to say
5 something about it. This was their policy. It's not like
6 advancement is some little tiny provision, you know, in the
7 fine print. Advancement is sometimes that's the whole purpose
8 of the contract. Though they were not the drafters of the
9 primary policy, they signed onto the terms of the primary
10 policy. They've got anything whether it's -- what their intent
11 was, they should have come forward and they didn't, so I think
12 having failed to do that, Your Honor, you could go on -- you
13 could if you were so inclined rule in our favor in terms of
14 summary judgment based on ambiguity, but that's not our
15 argument.

16 THE COURT: Okay. Okay. I think they're done.

17 MS. GILBRIDE: Okay. Sure. Just addressing a couple
18 of things that Ms. Kim argued, Your Honor.

19 She argued that the second sentence of (d)(2) would
20 be superfluous if our position with respect to the first
21 sentence was adopted by the Court. That's just not accurate.

22 The second sentence of (d)(2) applies in a situation,
23 the exact situation that the primary and first Axis carriers
24 are in where they have advanced defense costs subject to a
25 reservation of rights based on other exclusions, not the same

1 exclusions as us, which require that there be an adjudication
2 in fact of the issues in those exclusions.

3 So the purpose of the second sentence of (d)(2) is
4 for those situations where an insurer says, well, we don't
5 think there's coverage but we can't make that determination now
6 based upon the language in those exclusions so we will advance
7 defense costs subject to a reservation of rights and subject to
8 recoupment later if there is an adjudication that satisfies the
9 language of those exclusions.

10 The exclusions that Axis is relying upon do not have
11 that language and, in fact, the argument that's being advanced
12 by the insureds, by some of the insured is -- would make that
13 second sentence of (d)(2) superfluous and it would make the
14 language of the exclusions that require an adjudication in fact
15 superfluous. Their argument -- so in order to reach the
16 conclusion that they're advancing you'd have to ignore the word
17 "covered" before defense costs and you'd have to ignore the
18 other provisions in the policy which provide mechanisms for
19 reimbursement in the event that there is an exclusion which
20 requires an adjudication in fact.

21 And, you know, then there's (d)(3), Your Honor,
22 which, you know, if you adopt the argument that the insureds
23 are advancing basically it would have been in Axis's interest
24 to say, well, we think one percent of this case is covered, so
25 we'll advance one percent of the defense costs. And they would

1 say, well, 100 percent is covered; (d)(3) would only require us
2 to advance undisputed defense costs and that can't be the way
3 that this works. That just makes no sense whatsoever.

4 THE COURT: Although that's how the District Court in
5 the Rigas [Ph.] case determined it.

6 MS. GILBRIDE: Your Honor, I don't think -- I'm
7 positive that the Rigas policy language did not have the word
8 "covered defense costs." That was not there.

9 THE COURT: But on that point, I mean, all of these
10 policies, including the WorldCom policy, allowed the insurer to
11 make the argument that this wasn't covered in some way or
12 another, either in the definition of a "loss" or "injury"
13 because it's a loss "under the policy" and so I just -- I'm of
14 a mind that you're putting too much weight on the word
15 "covered," because an exclusion is an exclusion. I mean, you
16 don't have to say to someone else "if we really meant it, it's
17 an exclusion" and these cases all deal with exclusions and say,
18 well, if there's an issue about an exclusion, then sorry,
19 insurer, you have to wait until that's determined and advance
20 the defense costs beforehand.

21 MS. GILBRIDE: Well, Your Honor, I think that that is
22 the position that most insurers thought was the law before you
23 had WorldCom and Tyco. And I think if we do get into extrinsic
24 evidence, it will be very clear that the word "covered" was put
25 right where it was based upon the court interpretations that an

1 insurer could not rely upon its own interpretation of its own
2 policy language. So that word "covered" is significant.

3 THE COURT: But is there any -- but that's just
4 speculation, right?

5 MS. GILBRIDE: I -- yes.

6 THE COURT: Okay.

7 MS. GILBRIDE: It is not -- it is speculation.

8 THE COURT: All right.

9 MS. GILBRIDE: But it's based upon knowledge of, you
10 know, how these policy language have -- policy provisions have
11 developed.

12 THE COURT: Well, no one has asserted that, though.

13 MS. GILBRIDE: I'm not an expert witness. I'm not
14 here before the Court as an expert witness.

15 THE COURT: Okay.

16 MS. GILBRIDE: No.

17 THE COURT: Well -- all right.

18 MS. GILBRIDE: But I think that -- I think that
19 you're right that insurers thought that that was the way it
20 worked.

21 THE COURT: I didn't say that.

22 MS. GILBRIDE: Before -- well, I think that, you
23 know, it was a reasonable interpretation of the WorldCom policy
24 to think that if there was an exclusion advanced that you could
25 rely upon your interpretation of the exclusion and there was no

1 need to use the word "covered" before defense costs.

2 So if you will, the word "covered" was inserted to
3 make it triply -- you know, very clear to anyone who looks at
4 it --

5 THE COURT: Well, again, I --

6 MS. GILBRIDE: -- that in order for there to be
7 advancement --

8 THE COURT: I mean, if it's on its face, if it's
9 really clear, I mean, again, I go with the judge in the Rigas
10 case. He seemed to think that you needed to be a lot clearer
11 than that, and then he made his somewhat offhand remark that
12 perhaps the insurers didn't do that because it would affect
13 their ability to sell policies, but --

14 MS. GILBRIDE: Your Honor, I read that dicta as well.
15 You know, of course, I read that. I don't think that, you
16 know, it's neither really here nor there nor the issue that we
17 have today.

18 THE COURT: Okay.

19 MS. GILBRIDE: You know, our position is that the
20 language is clear.

21 With respect to Mr. Walsh's position with respect to
22 the -- whether they've denied that the exclusion applies, I
23 don't think that there's -- I'm not aware of anything in the
24 underlying action that involves the exclusionary language. I'm
25 certain that his clients have denied that there's a fraud, but

1 I don't think that that is enough evidence to establish that
2 they've denied that the exclusion applies.

3 THE COURT: Well, but didn't they say in their motion
4 to dismiss that under the overlap doctrine I couldn't decide
5 this coverage issue because the underlying issue of the fraud
6 was at issue in the District Court actions?

7 MS. GILBRIDE: They did. They did make that
8 argument.

9 THE COURT: Okay.

10 MS. GILBRIDE: Our position is not -- is not based on
11 fraud. We don't -- you know, we're not basing our coverage
12 position based upon a fraud exclusion. It's based upon a prior
13 knowledge exclusion and a warranty.

14 THE COURT: But it's a prior knowledge of fraud.

15 MS. GILBRIDE: It's a prior knowledge of facts or
16 circumstances that could lead to a claim. It doesn't have to
17 be prior knowledge of a fraud. It so happens that in this case
18 apparently -- you know, there are allegations that it was
19 apparently a fraud, but that's not what the exclusion or the
20 warranty letter said. It's just knowledge of acts or
21 circumstances.

22 THE COURT: All right. But there -- I mean, there's
23 no dispute that it has to be wholly within the exclusion to be
24 excluded, right? I mean, the cases are pretty clear on that.

25 MS. GILBRIDE: Yes, Your Honor.

1 THE COURT: So, for example, if there's a dispute
2 about fraud and there be one of the counts, of the ones that
3 are being sued, is a fraud suit, then it would seem to me it
4 would -- they'd be denying it, but the exclusion applies.

5 MS. GILBRIDE: Well, I don't read it that way, Your
6 Honor, but --

7 THE COURT: Okay. Can I turn to the cross-motion for
8 a declaration that if I were to grant the movants' motion, the
9 insureds' motion, it's subject to refund?

10 MS. GILBRIDE: Yes, Your Honor. That's an argument
11 that Axis is advancing.

12 THE COURT: What is -- I mean, is -- it's not -- to
13 me it doesn't seem to be an issue now, so you have to, I think,
14 rely on the other basis for a declaratory judgment that somehow
15 your actions are adversely affected by not knowing the answer
16 to that question. I just -- how would that -- how is that the
17 case here?

18 MS. GILBRIDE: Well, Your Honor, we believe that Your
19 Honor made it clear that you could interpret the policy. You
20 could construct the policy as a matter of law. We're simply
21 asking the Court to construct the policy the same provision
22 that the insureds are relying upon to say that they -- that
23 defense costs should be advanced, that if they are advanced,
24 they should be repaid if there's an ultimate determination.

25 THE COURT: Well, but the issue is whether it's ripe

1 to do that at this point.

2 MS. GILBRIDE: Well, it's certainly Axis's position
3 that the issue is ripe. You know, Axis is being asked to
4 advance defense costs where Axis's position is if there's no
5 coverage for the defense costs and Axis issued a policy that
6 says in that situation a second sentence of (d)(2) that if
7 there is an ultimate determination that there's no coverage
8 that Axis is entitled to repayment.

9 THE COURT: But why -- well, why is this different
10 than cases like WorldCom and Koslowski? Well, or the G-1
11 Holdings case, where the courts all say as part of their
12 analysis of the contract that the bargain here was to advance
13 the defense costs subject to reimbursement under the provision
14 which has the same language in it essentially that this
15 contract has in (d)(2) that if it's later determined that it
16 wasn't covered that it be reimbursed. I mean, that -- those
17 weren't declaratory judgments. Those were statements as part
18 of the rationale of the court's decision in interpreting the
19 contract.

20 My question goes to why does -- why should I be
21 issuing a declaratory judgment on top of that when I don't
22 know, for example, when there's no request or no refusal -- put
23 it that way, no refusal, first, and then no request to enforce
24 the contract in light of the refusal, to refund the advanced
25 defense costs?

1 MS. GILBRIDE: Just addressing your first question,
2 Your Honor, I don't know that a declaratory ruling was
3 requested in those cases that Your Honor is referring to, so
4 for that reason it may not have been addressed by those courts.

5 THE COURT: Right.

6 MS. GILBRIDE: Our position is that just simply based
7 upon the Court's inherent power to interpret these insurance
8 policies that Your Honor has the power to say that in the event
9 that it is finally determined that these defense costs are not
10 covered, that they should be reimbursed.

11 THE COURT: Okay.

12 MS. GILBRIDE: And it's based upon, you know, the
13 federal declaratory judgment action.

14 THE COURT: Well, I guess that's where I'm having a
15 problem. I don't see how it is really based on the federal
16 declaratory judgment statute since there's no immediate
17 controversy and I'm not hearing any argument that there's the
18 type of doubt in Axis's mind that the contract wouldn't be
19 interpreted the way Axis says it should be interpreted. I
20 mean, no one's --

21 MS. GILBRIDE: Well, there's a lot of doubt in Axis's
22 mind about that, Your Honor.

23 THE COURT: Well, where is that stated? I didn't see
24 that. Where is the -- where's that hook under the declaratory
25 judgment act?

1 MS. GILBRIDE: Your Honor, I think if you look at the
2 broad powers that are enumerated in that statute, that would --
3 you know, it's our position that Your Honor does have the power
4 to issue --

5 THE COURT: All right. I know you said that.

6 MS. GILBRIDE: -- that sort of --

7 THE COURT: But I'm not satisfied by that. I need to
8 hear why I need to do it, because I think I only really have
9 the power if I need to do it.

10 MS. GILBRIDE: Your Honor, we've, you know, cited in
11 our papers the relevant provisions of the statute. If Your
12 Honor doesn't agree with that cite, you know, I don't know what
13 more I can say to convince Your Honor of that.

14 THE COURT: Okay. All right. Okay.

15 MS. MOSES: Barbara Moses, Your Honor. I represent
16 Mr. Trosten. Very briefly, just on the last point, the cross
17 motion for an additional declaration of rights under the
18 policy. What Your Honor said was that you didn't think you had
19 the power to do it unless you needed to do it and I think
20 that's exactly right. I would approach this issue not so much
21 from the point of view of ripeness, but more fundamentally from
22 the question of whether there is even a justiciable controversy
23 here. That's a constitutional requirement before a declaratory
24 judgment may be issued. Since there has been no demand for
25 repayment, no refusal to repay, no showing or suggestion of

1 anything other than a doubt in counsel's mind as to whether
2 such a dispute ever would develop in the future, I don't think
3 we have a justiciable controversy here. Thank you.

4 THE COURT: Okay.

5 MR. KLINE: Your Honor, Ivan Kline for Sexton and
6 Sherer. I think Your Honor has already recognized that
7 Ms. Gilbride's statement was just pure speculation, but just so
8 the record is clear, it's not only speculation but on the face
9 of the document she submitted it's -- herself to the Court --
10 it's wrong in terms of the sequence of how the word "covered"
11 arrived in this policy, since in the Carlin Equity case that
12 she -- that she submitted on Wednesday, the court made clear
13 that that -- which is the identical policy language in the
14 identical primary carrier, that policy was written in 2003, so
15 the language that started here in August 2005 was not a
16 response to WorldCom and Koslowski. It appeared in 2003 and
17 was continued following the Koslowski decision in 2004 and the
18 WorldCom decision in February 2005.

19 THE COURT: Okay.

20 [Pause in the proceedings.]

21 THE COURT: Where's the date of that policy stated in
22 here in the Carlin opinion?

23 MR. KLINE: The very first paragraph of the opinion,
24 Your Honor. It says in 2003 Carlin purchased a directors &
25 officers [ph.] and that is the policy where the -- on the

1 same -- I think Houston Specialty -- Houston Cad [Ph.], I
2 believe, is the same company as U.S. Specialty.

3 THE COURT: Okay.

4 MR. KLINE: It's the same language that is in the
5 primary policy.

6 THE COURT: Okay.

7 MS. GILBRIDE: Your Honor, it was pure speculation on
8 my part.

9 THE COURT: Okay. All right.

10 [Pause in the proceedings.]

11 THE COURT: All right. I have before me in this
12 adversary proceeding motions for summary judgment in respect of
13 the claim that Axis Reinsurance Company is obligated to advance
14 defense costs to the insured's under its excess liability
15 policy on behalf of directors and officers of Refco, Inc.

16 The movants, all former directors and officers or
17 officers of Refco, are Messrs. Klejna, Sexton, Sherer,
18 Silverman, and Murphy, Messrs. Brightman, Gantcher, Harkins,
19 Jackel [Ph.], Lee, O'Kelley and Shone [Ph.] and Messrs. Grant,
20 Trosten and Bennett. I believe that includes all the moving
21 insureds.

22 Federal Rule of Civil Procedure 56(c), which is made
23 applicable in bankruptcy proceedings in bankruptcy cases
24 pursuant to Bankruptcy Rule 7056 controls the standard in
25 respect to these motions for summary judgment. Rule 56(c)

1 provides that summary judgment shall be granted if the
2 pleadings, depositions, answers to interrogatories and
3 omissions on file together with affidavits, if any, show that
4 there is no genuine issue as to any material fact and that the
5 moving party is entitled to judgment as a matter of law.

6 Siltex Corporation v. Cantrent [Ph.], 477 U.S. 317 (322 1986).

7 In deciding a motion for summary judgment, the Court
8 must determine if there are any material factual issues to be
9 tried while at the same time since the nonmoving party would be
10 precluded from a trial if the relief were granted the Court
11 should resolve ambiguities and draw reasonable inferences in
12 favor of the party opposing the motion. Matsushita v. Zenith
13 Radio Corporation, 475 U.S. 574 (587 1986); Knight v. U.S. Fire
14 Insurance Company, 804 F.2d 911 (2d Cir. 1986).

15 The burden ultimately rests on the moving party to
16 establish the absence of a genuine issue as to any material
17 fact, Siltex 477 U.S. at 322-23. The nonmoving party may
18 oppose a summary judgment motion by making a showing that
19 there's a genuine issue as to a material fact in support of a
20 verdict for that party, Anderson v. Liberty Lobby, Inc., 477
21 U.S. 242 247-48 (1986). That is the mere existence of a
22 scintilla of evidence in support of its position will be
23 insufficient. There must be evidence on which a jury could
24 reasonably find for the nonmoving party. *Id.*

25 That is, the nonmoving party may not defeat a summary

1 judgment motion by relying on self-serving or conclusory
2 statements. There must be something more than some
3 metaphysical doubt as to a material fact. That is, there needs
4 to be specific evidence of a material fact at issue, although
5 of course once that evidence is shown, the Court moves on to
6 the trial stage, that is, the evidence need not be probative at
7 the summary judgment stage. See generally again, Matsushita v.
8 Zenith, 475 U.S. at 586.

9 In this case the question before the Court is whether
10 there's a genuine issue of material fact as to whether Axis'
11 unilateral decision to deny payment of defense costs to the
12 plaintiff insured's was a breach of the Axis policy. In
13 determining that issue on summary judgment, the parties have
14 directed me primarily to rely upon the terms of the policy and
15 in particular the terms of the provision governing the
16 advancement of defense costs, paragraph (d)(2), as well as
17 various claims claimed, exclusions to the policy. They have
18 submitted their statements of undisputed material facts and in
19 Axis's case a response in certain instances controverting those
20 statements.

21 In reviewing that record, it is clear to me that
22 primarily this is a dispute upon which the Court must focus on
23 the language of the relevant provisions of the insurance
24 policy. Accordingly, this falls into the category as noted by
25 numerous courts that summary judgment is a particularly

1 appropriate vehicle for determining insurance coverage
2 disputes. See United Capital Corporation v. Travelers
3 Indemnity Company of Illinois, 237 F. Supp. 2d 270, (274
4 S.N.D.Y. 2002). And that is because generally insurance
5 company disputes hinge, as this one does, on the terms of the
6 contract and contract determination generally leads itself or
7 lends itself to summary judgment analysis.

8 I previously determined in this proceeding that the
9 dispute in particular the interpretation of the contract under
10 the dispute is governed by New York law having applied in New
11 York law, choice of law analysis and determined, as I set forth
12 on the record of the hearing on August 30, 2007, that New York
13 choice of law principles given the locus of the dispute and
14 generally speaking the domicile of the parties would lead to
15 New York applying.

16 That transcript is attached to the parties
17 submissions, both Ms. Kim's declaration as well as
18 Ms. Gilbride's declaration in support of Axis's cross motion at
19 Exhibit B.

20 Under New York law generally a contract -- a written
21 contract is to be interpreted so as to give effect to the
22 intention of the parties as expressed in the unequivocal
23 language they've employed, Kruden v. Bank of New York, 957 F.2d
24 961 (976 2d Cir. 1992). Under New York law if a contract is
25 unambiguous on its face its proper construction is a question

1 of law. The Court should not look beyond its confines to
2 extrinsic evidence if its relevant provisions are clean and
3 unambiguous. See generally Metropolitan Life Insurance Company
4 v. RJR Nabisco, Inc., 906 F.2d 884 (889 2d Cir. 1990); WWW
5 Associates, Inc. v. Gencontiari [Ph.], 77 NY 2d 157 (162 1990);
6 and Vermont Teddy Bear Company, Inc. v. 538 Mass Realty
7 Company, 1 NY 3d 470 (2004).

8 Giving the terms of the contract their plain meaning,
9 a court should find contractual provisions ambiguous only if
10 they are reasonably susceptible -- if they are reasonably
11 susceptible to more than one interpretation by reference to the
12 contract alone. Crummy v. Westpoint Stevens, Inc., 238 F.3d
13 133 (139 2d Cir. 2000). Contract language is unambiguous if it
14 has a definite and precise meaning unintended by danger of
15 misconception in the purport of the contract itself concerning
16 which there's no reasonable basis for difference of opinion.
17 Metropolitan Life Insurance v. RJR Nabisco, 986 F.2d -- excuse
18 me -- at 889, language whose meaning is otherwise plain is not
19 ambiguous merely because the parties urge different
20 interpretations in the litigation. Id.

21 Those contract interpretation rules are generally
22 followed in New York in respect of insurance policies, but in
23 addition to those general principles there are specific
24 contract interpretation rules that apply to insurance policies
25 that are relevant to this dispute or potentially relevant.

1 With regard to the first proposition that with regard
2 to the interpretation of the insurance contract, the courts
3 view the plain language of the contract as the best and if
4 plain the only measure of the parties intentions and that the
5 initial interpretation of the contract is a matter of law for
6 the Court to decide is set forth in among other decisions cited
7 by the parties. In Re: WorldCom, Inc, Securities Litigation,
8 354 F.Supp. 2d 455 at 463 (464 S.D.N.Y. 2005).

9 However, in that opinion District Judge Cote goes on
10 to state real established rules with regard to insurance
11 contracts, in particular in New York. That is, first that to
12 the extent an ambiguity exists in respect of an insurance
13 contract governed by New York law and is unresolved by
14 extrinsic evidence, such ambiguity is read against the insurer.
15 See also Nekostis v. Home Insurance Company of Indiana, 31 F.3d
16 910 (113 2d Cir. 1994). Going on, Judge Cote says the rule
17 that insurance policies are to be construed in favor of the
18 insured as most rigorously applied in construing the meaning of
19 exclusions incorporated into a policy of insurance or
20 provisions seeking to narrow the insurer's liability.

21 Finally, under New York law where a contract of
22 insurance includes the duty to defend or to pay for the defense
23 of its insured and I note that Judge Cote makes no distinction
24 between the two concepts, *i.e.*, duty to defend or duty to pay
25 for the defense of its insured, that duty is "a heavy one" and

1 indeed has been found for many years to apply even if the
2 policy of indemnity does not specifically provide for
3 advancement.

4 "In sum" -- again, I'm quoting from the WorldCom
5 opinion at page 464 -- "the duty to pay defense costs is
6 construed liberally and any doubts about coverage are resolved
7 in the insured's favor." My review of Axis's statement of
8 additional facts and response to statement of undisputed
9 material facts submitted in response to various of the movants,
10 Rule 7056(1) statements that most of the issues in this case
11 are uncontroverted, obviously, the terms of the underlying
12 policy which incorporates with the specific exceptions stated
13 in the Axis policy the primary policy issued by the primary
14 insurer.

15 In addition, Axis does not dispute that the
16 underlying litigation against the insureds constitutes claims
17 as a defined term for wrongful acts as defined in the primary
18 policy or that the movants here are insured or are insureds or
19 that they have incurred and will continue to incur defense
20 costs under -- or in response to the underlying litigations.

21 There's also no dispute and of course the policy
22 speaks for itself that the term "loss" in the primary policy as
23 incorporated with specific exceptions by the Axis policy
24 includes defense costs and insured person is legally obligated
25 to pay as a result of any claim. It's also not disputed that

1 the insureds have given Axis notice on a timely basis of their
2 claim of the policy.

3 What is disputed by Axis is first whether exclusions
4 unique to its policy, which I primarily take to be the prior
5 knowledge exclusion set forth in endorsement number six to the
6 policy, but also other potential exclusions and defenses apply
7 here to prevent the defense costs from being covered under the
8 policy.

9 In addition, the parties dispute whether under the
10 language of the primary policy specifically paragraph (d)(2)
11 Axis is obligated to pay defense costs on an as-occurred basis
12 in light of its contention that the exclusions that it has
13 noted apply and preclude coverage. The issue was first raised
14 by Axis. Apparently in a letter attached Exhibit 9 to the Kim
15 declaration disclaiming coverage on the basis of various
16 disclosures -- exclusions as well as breach of warranty.

17 Notably, Axis has not offered any material fact as to
18 any extrinsic interpretation of paragraph (d)(2) that I've
19 referred to or any other provision for that matter of the
20 applicable insurance policies.

21 I conclude based on the record before me for purposes
22 of these motions that, in fact, there is a dispute as to
23 whether the policy exclusions would apply here to render the
24 losses including defense costs not covered by the policies.
25 Specifically, each of the movants, each of the insureds has in

1 this adversary proceeding taken the position that it is not
2 precluded from coverage by the knowledge exclusion and
3 furthermore certain of the insureds as set forth in Exhibits
4 10, 12 and 13 of the Kim declaration at paragraphs 43 through
5 45 and in addition taken the position that the knowledge
6 exclusion itself is an improper endorsement to the policy.

7 I previously ruled as is set forth in the transcript
8 of the August 30, 2007 hearing that the issue of whether, in
9 fact, the insured's losses are covered under the Axis policy in
10 light of the prior knowledge exclusion, as well as the other
11 exclusions and defenses raised by Axis, may not be decided at
12 this time in light of the substantial overlap of those issues,
13 *i.e.*, whether in fact there was a prior knowledge of a claim
14 and/or loss.

15 With the issues pending before the District Courts in
16 the multi-district securities litigation as well as in respect
17 to certain of the insureds pending criminal litigation in the
18 Southern District, I won't repeat that ruling now except to
19 note that in my view it was dictated by clear precedent which,
20 as was brought out at the hearing and is set forth in the
21 transcript, essentially puts the interest of the insured in
22 having a prompt determination of such an issue behind the
23 interest of the insured to pursue its defense of the primary
24 litigation that allegedly gives rise to the claim or loss.

25 That context is important to keep in mind, however,

1 in connection with the present motions because it sets the
2 stage for the -- what I believe to be fairly narrow issue
3 before me. Again, that issue ultimately depends upon the
4 Court's interpretation of the following provision, paragraph
5 (d)(2) of the Axis policy which states incorporating the
6 provision from the primary policy, "The insurer will pay
7 covered defense costs on an as-incurred basis. If it is
8 finally determined that any defense costs paid by the insurer
9 are not covered under this policy, the insured has agreed to
10 repay such noncovered defense costs to the insurer."

11 Axis contends that it is permitted by that language
12 to determine unilaterally not to pay defense costs on an as-
13 incurred basis if it believes that such defense costs are not
14 covered under the policy, that is, that they would be subject
15 to the exclusion or the exclusions under the policy. The
16 movants contend to the contrary that Axis is obligated under
17 the paragraph that I just read, particularly when construed in
18 light of relevant case law and the presumptions that I noted
19 earlier applying to exclusions and insurance policies generally
20 to mean that until there is a final determination by an
21 objective fact finder that the defense costs are not covered,
22 Axis is obligated to advance them. They say this again because
23 they contend and I conclude the record supports this that there
24 is a legitimate dispute as to whether defense costs are covered
25 or not under the policy.

1 Both sides have asserted principles of contract
2 interpretation or a principle of contract interpretation to
3 assist the Court in determining whether the language that I
4 just quoted is ambiguous or not. Not surprisingly, they both
5 contend that the language is not ambiguous, although equally
6 not surprising they both contend that it means the opposite of
7 what the other says it means.

8 The principle they relied on primarily is that a
9 court should read a contract in whole giving meaning to all of
10 its parts and avoid interpretation that would render other
11 provisions useless and meaningless and I have looked at the
12 other provisions of the contract, in particular, paragraph 3 as
13 well as the interplay of the two sentences in paragraph (d)(2).

14 Frankly, after having done so, I do not believe that
15 the contract interpretation maxim that I just recited is of
16 much help in that one could conceive of uses for the language
17 in paragraph (d)(2) to support both sides' position. I believe
18 that (d)(3) is really a provision going to a separate
19 proposition and consistent with, again, the principles pursuant
20 to which courts in New York interpret insurance policies and
21 particularly exclusions to the advancement of defense costs,
22 (d)(3) should be read narrowly and not be used to extend over
23 into interpretation of (d)(2).

24 However, there is a more meaningful point to note
25 about the rest of the policy, which is that nowhere does it

1 state that or imply except in (d)(3) in the specific instance
2 covered thereby that the insurer can unilaterally or in the
3 exercise of its reasonable judgment or in any other way
4 withhold defense costs absent a court determination in the
5 event of a dispute as to whether defense costs are covered.

6 In light of the case law that I will go into in a
7 minute, as well as the function of advancing defense costs, I
8 conclude that the absence of such language in addition to the
9 language of (d)(2) says that "The insurer will pay and provide
10 for refund mechanism if noncovered defense costs are finally
11 determined. "Not to be covered" means that the reasonable and
12 ordinary course colloquial interpretation of paragraph (d)(2)
13 is that absent a final determination by an objective fact
14 finder the insurer is obligated to pay the defense costs
15 notwithstanding its view that those costs are excluded under
16 the policy.

17 As I said, I believe this language is clear in the
18 context of the entire agreement and it's in the absence of that
19 agreement of any provision conferring on the insurer the
20 unilateral ability to make such a determination, but I note to
21 that to the extent that an ambiguity exists the insurer has
22 offered up no extrinsic evidence in support of its position for
23 interpreting paragraph (d)(2). Consequently, I believe that
24 under the law of New York in the absence of offering up such
25 evidence the ambiguity would have to be interpreted against the

1 insurer. Again, see Macostis v. Home Insurance Company
2 [inaudible], 31 F.3d 110 at 113 2d Cir. 1994, as well as the
3 discussion in Multi-Foods Corporation v. Commercial Liens
4 Insurance Company [Ph.], 309 3d 76 (8807 2d Cir. 2002).

5 As I alluded to a moment ago, I'm not writing on a
6 clean slate with regard to this issue. As far as I can tell,
7 every court that has considered the issue and again I believe
8 it's a narrow issue as to whether during the pendency of a
9 dispute as to coverage under the policy an insurer may withhold
10 the payment defense costs has concluded that to the contrary
11 the insurer is obligated to advance the defense costs with the
12 caveat that if it is clear from the policy itself and claim
13 made against the insured that the claim would not be covered
14 then such an obligation could be decided on a summary judgment
15 basis and no defense costs would need to be advanced.

16 Here as I noted, that issue is not clear.
17 Consequently, I believe that the case law would support my
18 conclusion that Axis is obligated to advance the defense costs.
19 This issue has most recently been dealt with more thoroughly in
20 Federal Insurance Company v. Tico International Limited, 784
21 NYS 2d 920, in which the Court after noting numerous cases that
22 considered the issue in other jurisdictions found that it is
23 "... well settled the duty of insurer to defend its insured or
24 pay its defense costs as distinct from and broader than its
25 duty to indemnify. The duty exists whether a complaint against

1 the insured alleges claims that may be covered under the
2 insurer's policy. If any portion of a complaint might result
3 in coverage, the insurer must defend or pay defense expenses
4 for all claims, both covered and noncovered. Conversely, the
5 insurer has no duty if as a matter of law the allegations in
6 the complaint could not give rise to any obligation to
7 indemnify or the allegations fall within the policy exclusion,
8 but the duty to defend or pay defense costs is construed
9 liberally and any doubts about coverage are resolved in
10 insured's favor. Furthermore, an insurer can only evoke a
11 clause exclusion to avoid coverage if it can show that the
12 allegations in the complaint as to pleading solely and entirely
13 within the policy exclusion."

14 Given the doubt raised by the movants, the insureds
15 in that summary judgment motion as to whether the insurer had
16 met those stringent tests, the Court concluded that pending a
17 final determination of those issues the insurer would need to
18 advance defense costs. I note that it did so notwithstanding
19 similar facts alleged as to at least one of the defendants
20 alleged fraud which were arguably analogous at least to the
21 conduct of Mr. Bennett.

22 The New York courts have twice since the Koslovsky
23 opinion adopted its rationale, although in one case apparently
24 in dicta in Ghose, G-h-o-s-e, v. CNA Reinsurance Company
25 Limited, 841 NYS 2d 519, Appellate Division First Department

1 2007 the Court stated, "We note, however, that the complaints
2 ere not being dismissed on grounds of inconvenient form. The
3 interim order defense costs would not be disturbed. New York
4 law requires that a judicial order is a condition precedent to
5 the cessation of payment for defense costs and circumstances
6 where a claim has already been made" citing Koslovsky.

7 Similarly, in Trustees of Princeton University v.
8 National Union Fire Insurance Company of Pittsburgh, 839 NYS 2d
9 437 (Supreme Court, New York County, 2007), the Court after
10 noting many of the same rules of construction that I quoted
11 from the Koslovsky case stated the insureds -- I'm sorry, the
12 insurer's duty to pay defense costs arises when the insured
13 incurs the expenses. Where coverage is disputed, insurers are
14 required to make contemporaneous interim advances of defense
15 expenses subject to recoupment in the event it is ultimately
16 determined the policy does not cover the claim.

17 A similar finding, albeit in respect of slightly
18 different language was reached by Judge Cote in the WorldCom
19 opinion that I cited earlier. Axis has attempted to
20 distinguish the WorldCom opinion on two bases, neither of which
21 I conclude succeed. The first is that Judge Cote was dealing
22 with a defensive rescission as opposed to a specific exclusion
23 in the policy. I don't accept that distinction because I
24 believe that in either case, the key point was that there was a
25 dispute as to whether there was any obligation to pay on the

1 insurer's part.

2 The second basis is that the advancement language in
3 the policy in WorldCom did not contain the word "covered"
4 before defense costs. And I gather used the word "shall" as
5 opposed to "will" before the word "pay." But for the same
6 reason that I don't believe the first distinction is
7 meaningful, I don't believe the second one is either.

8 In either case, the issue hinged upon whether the
9 insurer could unilaterally act to withhold payment based on its
10 interpretation of whether it was obligated to pay a coverage or
11 whether the policy was void ab initio. I believe Judge Cote's
12 logic would apply under either scenario.

13 The issue was addressed -- the issue that I just
14 discussed was addressed expressly by the District Court for the
15 Eastern District of Pennsylvania in Associated Electric and Gas
16 Insurance Services Limited v. Ritas, 382 F. Supp. 2d 685
17 (E.D.P.A. 2004). Because of a prior Third Circuit opinion, the
18 Court in the Regius case had little trouble finding that the
19 insurer's rescission allegation did not give it the unilateral
20 right to withhold defense costs relying instead upon Little v.
21 MGIC Indemnity Corporation, 836 F.2d 789 (3d Cir. 1987).

22 The Court separately considered however whether a
23 unilateral right existed in respect to advancement of defense
24 costs because of applicable exclusion from coverage including a
25 prior knowledge exclusion, which like this exclusion did not

1 require a final adjudication for the exclusion to take effect.
2 As here, however, the Court in the Regius case noted that the
3 prior knowledge exclusion also does not contain any language to
4 suggest that it operates at the discretion of the insurer.

5 In the Regius case, the Court determined that the
6 carriers had a duty to contemporaneously pay defense costs
7 given the language in respect of defense costs and the
8 indemnity policy generally triggering an obligation to pay
9 wherever the insured was legally obligated. As here, there was
10 no dispute in the Regius case that the insureds owed money to
11 the lawyers defending in civil suits and that this was a legal
12 obligation. Thus, the carriers had a duty to contemporaneously
13 pay defense costs and it's altered by other language in the
14 policy.

15 The Court concluded that the knowledge exclusion was
16 ambiguous because it settled two different interpretations as
17 to whether a unilateral right was lodged in the insurer and
18 since Pennsylvania law was similar to New York law, it must be
19 construed in favor of the insureds and against the insurers.
20 Here, as I said, I go further and find that the absence of such
21 a provision in light of paragraph (d)(2) means that (d)(2) is
22 not ambiguous, but as I said before based on the absence of any
23 extrinsic evidence offered to clarify any alleged ambiguity,
24 the provision would be construed in favor of the insureds and
25 against the insurer here.

1 Two other recent cases from other jurisdictions which
2 generally have the same basic insurance law contract
3 interpretation principles also worth noting, first, G-1
4 Holdings, Inc. v. Reliance Insurance Company, 2006 U.S.
5 District Lexus 17597, District of New Jersey, March 22, 2006,
6 where the Court concluded that although the defendants argue
7 that various exclusions operate to bar the potential that the
8 underlying claims will be covered, "An insurer's duty to defend
9 is determined by comparing the allegations of the underlying
10 complaint with the language of the policy at issue. Here, the
11 Court has already found that there is a potential for coverage
12 should the alleged facts prove" -- I'm sorry -- "be proven true
13 particularly where again as here the policy provides that if it
14 does not apply" -- I'm sorry -- "that is later adjudicated that
15 it does not apply to the underlying allegations, the policy
16 specifically provides that the insurer would be reimbursed.
17 The insurer is obligated where there is a reasonable potential
18 for coverage to advance the defense costs."

19 The Court in Sometimes Media Group, Inc. v. Royal and
20 Sun Alliance Insurance Company of Canada, 2007 WL 1881 265, Del
21 Super June 20, 2007 makes a similar point. "Furthermore, the
22 personal exclusions do not override a present contractual duty
23 to advance defense costs unless the defendants can
24 unequivocally now show that all of the obligations in the
25 underlying class action complaint fall within the personal

1 conduct exclusions. Since the defendants have failed to show
2 at this time the applicability of exclusions to International,
3 the Court need not decide the potential applicability of
4 exclusions at this time."

5 Again, the Court noted that the policy provided as
6 paragraph (d)(2) does here "Such advance payments by the
7 insurer shall be repaid to the insurer to the extent that any
8 such insured shall not be entitled under the policy ultimately
9 to such payment." And then it concluded, "Therefore, the plain
10 language of the policy guaranteeing an advancement of defense
11 costs is not precluded by an imputation of exclusions to
12 International as well as explained earlier to the outside
13 directors."

14 In light of that case law, I conclude that under the
15 language of the policy concluding its incorporation of the
16 extensive case law regarding how such policies are to be
17 interpreted in New York that pending a resolution of the
18 coverage dispute Axis is obligated to advance defense costs.
19 That is, in some instances an issue that the Court could and
20 does decide promptly here because of the substantial overlap
21 document it cannot be decided by me, but that is not a reason
22 for changing the rule that I have just articulated. As is
23 again, I believe, supported by the Regius case from
24 Pennsylvania where the District Court was precluded by the
25 automatic stay in the Adelphia bankruptcy cacaos from deciding

1 a coverage issue and nevertheless concluded that the insurer
2 was obligated to advance the defense costs. So for those
3 reasons, I will grant the insured's motions for summary
4 judgment.

5 Let me turn then to the cross motion for summary
6 judgment by Axis, which seeks a declaratory judgment that if,
7 in fact, it is subsequently determined by a court that the
8 defense costs are not covered, i.e., that an exclusion applies
9 or for some other reason they're not covered by the policy, the
10 insureds to have received the defense costs are obligated to
11 repay those costs to Axis.

12 Obviously, the contract provision that I quoted
13 earlier, paragraph (d)(2) says what it says. And the fact that
14 it provides for repayment is an element of my reasoning as it
15 was in numerous other cases that I cited and quoted from.
16 However, I do not believe that Axis has set forth the basis
17 under the declaratory judgment act for a ruling on its motion
18 given that I believe there is no judicable controversy before
19 me, no insurer has refused to return any funds obviously
20 because there's yet to be any determination that such payments
21 were not covered or such losses were not covered under the
22 policy.

23 To my knowledge, no insurer has disclaimed that that
24 would be the appropriate result if such a determination
25 eventually is made and Axis has not pointed me to any such

1 disclaimer or other basis to sustain an argument that
2 notwithstanding a right controversy it has legitimate concern
3 that such contractual provision would be breached and,
4 therefore, would be entitled to a determination now. So
5 consequently, I will deny that motion without prejudice on the
6 basis that, again, it does not set forth the basis on
7 declaratory judgment act for relief given the absence of a case
8 of controversy and a lack of any rightness.

9 There was no formal motion for an allocation of the
10 priority of the payments to be made by Axis. I have, I
11 believe, dealt with this issue before in my prior rulings in
12 this matter. I do not believe that request is properly before
13 me in the form of a motion or a properly raised controversy.
14 It may ultimately be one, but in the first instance I believe
15 that there has to be some dispute as to the allocation of
16 priority and that in the absence of such dispute the terms of
17 the contract will govern the party's conduct.

18 So the orders granting the summary judgment motions
19 should provide that the Court has not determined any issue with
20 respect to the priority of the advancement of defense costs and
21 that all parties' rights and indeed all nonparties' rights in
22 respect of priority allocations are fully preserved and
23 reserved.

24 As I normally do when I give a lengthy bench ruling,
25 particularly when I quote cases, I'll go over the transcript of

1 my ruling and reserve the right to amend it, both to correct it
2 and to add something if I believe it was -- it should properly
3 added, but my ruling won't change, which is that the summary
4 judgment motions are granted.

5 So I would ask each of the -- well, not each of you,
6 but the respective counsel for the groups of movants and
7 Mr. Murphy to submit orders for their respective clients
8 consistent with my ruling.

9 MS. KIM: Your Honor, we believe our proposed order
10 is ready.

11 THE COURT: I don't think I have it on a disk,
12 though.

13 MS. KIM: I'll submit it, Your Honor.

14 THE COURT: Okay. You could email them to chambers.

15 MS. KIM: Yeah, it says -- already says exactly that
16 same language.

17 THE COURT: And you should cc: -- you don't need to
18 settle it on Axis, but you should cc: Ms. Gilbride when you
19 send it to chambers.

20 MS. KIM: Oh, they are.

21 THE COURT: So that she can make sure it's consistent
22 with my ruling.

23 MS. KIM: Your Honor, may I raise one housekeeping
24 issue?

25 THE COURT: Yes.

1 MS. KIM: Mr. Klejna would like to make a motion for
2 summary judgment on coverage. We believe we can do so without
3 going into the issue of anyone's knowledge because as the
4 Court -- as the Court previously recognized in retaining
5 jurisdiction on the counterclaim plaintiffs' complaint, we can
6 prevail as a matter of law, for example, on the knowledge
7 exclusion by demonstrating that as a matter of law the
8 exclusion is not a part of the policy, because it was
9 improperly added after the fact. We believe we can show --

10 THE COURT: But don't they have all the warranty --
11 don't they have the warranty issues as well?

12 MS. KIM: Well, Your Honor, we can show that the
13 warranty is not a part of the policy as a matter of law also.
14 It's not a part of the allocation.

15 THE COURT: What I'm going to ask you to do is put
16 this in a letter to me, cc'ing Ms. Gilbride. It's not
17 something I can --

18 MS. KIM: Oh, I was just going to ask --

19 THE COURT: No, I'm not going to give you leave to go
20 forward on the summary judgment motion on just what you've told
21 me today. I think you have to look at all of the exclusions
22 that Axis has raised and not just the knowledge exclusions and
23 I'm sorry, all of the defenses that Axis has raised and --

24 MS. KIM: We understand, Your Honor.

25 THE COURT: -- convince me that there's a reasonable

1 basis to go ahead on summary judgment notwithstanding the
2 substantial overlap.

3 MS. KIM: Yes, sir. I'll do so, Your Honor. We
4 don't believe that all the insureds are necessarily in the same
5 position.

6 THE COURT: No, you're just going to be speaking for
7 your particular client.

8 MS. KIM: Understood. Will do. Thank you, Your
9 Honor.

10 MR. JEROME: I assume, Your Honor, that she'll also
11 cc: the other insureds if different than --

12 THE COURT: That's right.

13 MS. KIM: All parties here.

14 THE COURT: Okay. All right. Okay. Anything
15 further?

16 ALL ATTORNEYS: Thank you, Your Honor.

17 (Proceedings concluded at 12:11 p.m.)

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I certify that the foregoing is a court transcript from an electronic sound recording of the proceedings in the above-entitled matter, except where, as indicated, the Court has modified the transcript.

Ruth Ann Hager

Dated: October 12, 2007

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